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Nos. 06-1457 and 06-1462

In the Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC.,
PETITIONER

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

CALPINE ENERGY SERVICES, L.P., ET AL.,
PETITIONERS

v.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY, WASHINGTON, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission reasonably interpreted the Federal Power Act, 16 U.S.C. 791a *et seq.*, in accord with this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), to provide for the modification of long-term electricity contracts only in extraordinary circumstances where the contracts are contrary to the public interest.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-67a) is reported at 471 F.3d 1053.[1] The orders of the Federal Energy Regulatory Commission (J.A. 1222a-1323a; J.A. 1554a-1614a) are reported at 103 F.E.R.C. ¶ 61,353, at 62,382, and 105 F.E.R.C. ¶ 61,185, at 61,979.

[1] All references to "Pet. App." are to the appendix in No. 06-1457.

JURISDICTION

The judgment of the court of appeals was entered on December 19, 2006. On March 8, 2007, Justice Kennedy extended the time within which to file petitions for a writ of certiorari to and including May 3, 2007, and the petitions were filed on that date. The petitions for a writ of certiorari were granted on September 25, 2007. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are set forth in an appendix to this brief. App., *infra*, 1a-15a.

STATEMENT

1. a. The Federal Power Act (FPA or Act), 16 U.S.C. 791a *et seq.*, grants the Federal Energy Regulatory Commission (Commission or FERC) exclusive jurisdiction over the "transmission of electric energy in interstate commerce" and the "sale of electric energy at wholesale in interstate commerce" by public utilities. 16 U.S.C. 824(b)(1). Proposed rates for the sale or transmission of power within FERC's jurisdiction are subject to FERC review to ensure that they are "just and reasonable" and not unduly discriminatory or preferential. 16 U.S.C. 824d(a) and (b). To that end, the FPA provides that:

> Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, * * * schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all

> contracts which in any manner affect or relate to such rates, charges, classifications, and services.

16 U.S.C. 824d(c). Rates filed under Section 824d become effective automatically unless rejected or suspended by the Commission. See 16 U.S.C. 824d(e).

The Act also provides for the Commission to review rates after they have been accepted for filing and gone into effect. Specifically, if, after a hearing—either on its own motion or based on a complaint—the Commission determines that any existing rate or charge is "unjust, unreasonable, unduly discriminatory or preferential," it must determine and fix by order "the just and reasonable rate * * * to be thereafter observed and in force." 16 U.S.C. 824e(a).

b. In *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*), this Court interpreted provisions of the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*, that parallel the FPA. The Court held that, "by requiring contracts to be filed with the Commission, the Act expressly recognizes that rates to particular customers may be set by individual contracts." 350 U.S. at 338. "In this respect," the Court explained, the Act is in marked contrast to the Interstate Commerce Act, ch. 104, 24 Stat. 379, which in effect precludes private rate agreements by its requirement that the rates to all shippers be uniform. *Ibid.*

The Court further concluded that the NGA does not empower a natural gas company unilaterally to modify its contracts with its customers. *Mobile*, 350 U.S. at 343. "By preserving the integrity of contracts," the Court observed, the statute promotes "the stability of supply arrangements which all agree is essential to the health of the natural gas industry." *Id.* at 344. "On the other hand, denying to natural gas companies the power uni-

laterally to change their contracts in no way impairs the regulatory powers of the Commission, for the contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest." *Ibid.* The Act thus affords a reasonable accommodation between the conflicting interests of contract stability on the one hand and public regulation on the other.

On the same day that it rendered its decision in *Mobile*, the Court held in *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*), that the FPA, like the NGA, did not authorize unilateral contract changes by the contracting parties. See *id.* at 353. The Court in *Sierra* also addressed the scope of the Commission's authority under 16 U.S.C. 824e(a) to change rates if it finds them to be "unjust, unreasonable, unduly discriminatory or preferential." In the underlying orders, the Commission had found a rate set by a contract to be unreasonable because it failed to yield the seller a reasonable rate of return. See *Sierra*, 350 U.S. at 354. The Court held that the Commission had applied the wrong standard in reviewing the contract: "[W]hile it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return," a utility nevertheless may agree by contract to accept such a rate, and, if it does so, it is not "entitled to be relieved of its improvident bargain." *Id.* at 355.

Instead, the Court explained, "the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other customers an excessive burden, or be unduly discriminatory." *Sierra*, 350 U.S. at 355. The Court found this focus on the "public

interest," as distinguished from the private interests of the utilities, to be evidenced by the recital in 16 U.S.C. 824(a) that the scheme of regulation imposed by the Act "is necessary in the public interest." *Sierra*, 350 U.S. at 355 (quoting 16 U.S.C. 824(a)). The Court therefore instructed that the matter be remanded to the Commission for further proceedings, noting that "[w]hether under the facts of this case the contract rate is so low as to have an adverse effect on the public interest is of course a question to be determined in the first instance by the Commission." *Ibid.*

c. Until the 1980s, the Commission established rates primarily on a cost-of-service basis. As barriers to entry in the generation sector declined, however, a competitive wholesale market for the supply of electric energy began to emerge. In response to that development, the Commission began considering and approving market-based rates for wholesale electric energy sales in the late 1980s.[2]

Under the Commission's market-based rate program, a seller may obtain Commission authorization to sell electric energy at market-based rates only if it first establishes that it and its affiliates do not have market power, or that any market power has been adequately

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[2] See generally *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Servs. by Pub. Utils.; Recovery of Stranded Costs by Pub. Utils. and Transmitting Utils.*, 75 F.E.R.C. ¶ 61,080, at 61,238 (Order No. 888) (61 Fed. Reg. 21,540 (1996)), clarified, 76 F.E.R.C. ¶ 61,009, at 61,024, and 76 F.E.R.C. ¶ 61,347, at 62,646 (1996), orders on reh'g, 78 F.E.R.C. ¶ 61,220, at 61,951 (Order No. 888-A) (62 Fed. Reg. 12,274 (1997)), 81 F.E.R.C. ¶ 61,248, at 62,069 (1997) (Order No. 888-B), and 82 F.E.R.C. ¶ 61,046, at 61,189 (1998) (Order No. 888-C), aff'd *sub nom. Transmission Access Policy Study Group* v. *FERC*, 225 F.3d 667 (D.C. Cir. 2000), aff'd *sub nom. New York* v. *FERC*, 535 U.S. 1 (2002).

mitigated. See *California ex rel. Lockyer* v. *FERC*, 383 F.3d 1006, 1009 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 (2007) (*Lockyer*). In reviewing an application for market-based rate authorization, the Commission undertakes an intensive factual review of the relevant product and geographic markets to determine whether, based on an analysis of market concentration during various seasons and load levels, the seller has market power. See *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity and Ancillary Servs. by Pub. Utils.*, 119 F.E.R.C. ¶ 61,295, at 62,653 (2007) (*Market-Based Rates*) (72 Fed. Reg. 39,904 (2007)), petition for reh'g pending; *AEP Power Mktg., Inc.*, 107 F.E.R.C. ¶ 61,018, at 61,048, on reh'g, 108 F.E.R.C. ¶ 61,026, at 61,110 (2004). Market power is defined as a seller's ability to "significantly influence price in the market by withholding service and excluding competitors for a significant period of time." *Citizens Power & Light Corp.*, 48 F.E.R.C. ¶ 61,210, at 61,777 (1989). In addition, for sellers in organized markets administered by regional transmission organizations or independent system operators, the Commission establishes market rules to mitigate the exercise of market power, adopts price and bid caps where appropriate, and establishes market monitors to help oversee market behavior and conditions. See *Market-Based Rates*, 119 F.E.R.C. ¶ 61,295, at 62,653.

The courts have held that, "[i]n competitive markets, FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a just and reasonable result." *Consumers Energy Co.* v. *FERC*, 367 F.3d 915, 922-923 (D.C. Cir. 2004) (Roberts, J.) (quotation marks and citation omitted); accord *Lockyer*, 383 F.3d at 1013 (noting that "[i]n a competitive market, where nei-

ther buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable") (quoting *Tejas Power Corp.* v. *FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990)); see *Louisiana Energy & Power Auth.* v. *FERC*, 141 F.3d 364, 365-366 (D.C. Cir. 1998). The Commission's review is designed to ensure that sellers cannot exercise market power and thus that rates charged are just and reasonable. See *PJM Interconnection, L.L.C.*, 121 F.E.R.C. ¶ 61,173 (2007).

To ensure that market-based rates remain just and reasonable, the Commission's market-based rate program imposes ongoing reporting requirements for market transactions. See *Lockyer*, 383 F.3d at 1013. For each contract subject to FERC's jurisdiction, sellers are required to report the buyer's and seller's name, a description of the service, the delivery point for the service, the price, the quantities to be served or purchased, the contract's duration, and any other attributes of the product being purchased or sold that contribute to its market value. See *British Columbia Power Exch. Corp.*, 99 F.E.R.C. ¶ 61,247, at 62,066 (*B.C. Power*), reh'g denied, 100 F.E.R.C. ¶ 61,295, at 62,328 (2002), review granted *sub nom. Lockyer*, 383 F.3d 1006 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 (2007). The reporting requirement provides a means for the Commission and the public to identify pricing trends or discriminatory patterns that might suggest the exercise of market power. See *id.* at 62,063.

"[A]fter-the-fact reporting allows the market to operate initially without regulatory intrusion," avoiding the costs and practical difficulties that would be associated with prior review of a large number of transactions, many of which are of short duration. *B.C. Power*, 99

F.E.R.C. ¶ 61,247, at 62,065. At the same time, the reporting requirement provides the Commission with information with which it can oversee the rates being charged, and it places sellers on notice that their market-based rate authority will be subject to continuing review and, if necessary, to remedial action, including the possible revocation of that authorization. *Ibid.* Upon finding a tariff violation, the Commission may take retroactive action, including ordering the disgorgement of unjust profits. *British Columbia Power Exch. Corp.*, 100 F.E.R.C. ¶ 61,295, at 62,334 (2002), review granted *sub nom. Lockyer*, 383 F.3d 1006 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 (2007); see *Lockyer*, 383 F.3d at 1015-1016.

2. In 1995, in response to retail electric rates that were above the national average, California comprehensively restructured its electric energy industry, with the Commission's approval. *Pacific Gas & Elec. Co.*, 77 F.E.R.C. ¶ 61,204, at 61,803-61,805 (1996), reh'g denied, 81 F.E.R.C. ¶ 61,122, at 61,435 (1997); see *In re California Power Exch. Corp.*, 245 F.3d 1110, 1114 (9th Cir. 2001). At the time, the major traditional investor-owned utilities were vertically integrated; that is, they owned generating resources, transmission lines, and distribution facilities. See *Lockyer*, 383 F.3d at 1008-1009 & n.2. Under the restructuring, those utilities were required to divest most of their generating assets and to purchase power at market-based rates through an independent power exchange, which operated an organized wholesale market, and an independent system operator, which managed the transmission network.

At first, the restructured California electricity markets operated largely as intended. Beginning in the summer of 2000, however, wholesale electricity prices in

California increased significantly, with the day-ahead market peaking at a 15-fold increase over the pre-restructuring average cost. See *In re California Power Exch. Corp.*, 245 F.3d at 1115 n.2. As the Commission later explained, the increase in prices resulted from an "unprecedented" confluence of "flawed market rules; inadequate addition of generating facilities in the preceding years; a drop in available hydropower due to drought conditions; a rupture of a major pipeline supplying natural gas into California; strong growth in the economy and in electricity demand; unusually high temperatures; an increase in unplanned outages of extremely old generating facilities; and market manipulation." *CAlifornians for Renewable Energy, Inc.*, 119 F.E.R.C. ¶ 61,058, at 61,247 (2007) (*CARE*). Between the summers of 2000 and 2001, load-serving utilities incurred billions of dollars of debt, and the independent system operator declared dozens of system emergencies and occasional rolling blackouts. *In re California Power Exch. Corp.*, 245 F.3d at 1115-1116. There also was "rampant" non-compliance with the reporting requirements of the market-based rate program. *Lockyer*, 383 F.3d at 1014.

To remedy the situation, FERC implemented structural and pricing reforms to make California and western electricity markets more stable and less susceptible to price spikes. See, *e.g.*, *California Power Exch.*, 245 F.3d at 1114-1116; *San Diego Gas & Elec. Co.*, 93 F.E.R.C. ¶ 61,294, at 61,982 (2000); see also pp. 31-32, *infra*. The Commission also urged California utilities to enter into long-term contracts, finding that a key structural flaw of the California market was the State's decision to place primary reliance on spot-market purchases. *Id.* at 61,993. As a result of these steps and

other factors, by early June 2001, prices in California spot and forward markets fell back to preexisting competitive levels. See *San Diego Gas & Elec. Co.*, 95 F.E.R.C. ¶ 61,418, at 62,546 (2001).

3. These cases involve long-term bilateral contracts for the sale of electric power that were entered into during the 2000-2001 western energy crisis. The purchasers were utilities in western states: respondent Public Utility District No. 1 of Snohomish County, Washington (Snohomish); respondent Southern California Water Company (SCWC); and respondents Nevada Power Company and Sierra Pacific Power Company (the Nevada companies). After prices fell, the purchasers filed complaints with FERC seeking reformation of their contracts. See, *e.g.*, J.A. 387a-428a. The Commission set the matter for a hearing before an administrative law judge (ALJ), J.A. 1080a-1122a, who made detailed factual findings concerning the contracts, Pet. App. 68a-245a.

a. Snohomish's contract called for the purchase of a specified quantity of power at a fixed price for a period of 8.75 years. Pet. App. 80a. SCWC signed a similar contract with a duration of 5.75 years. *Ibid.* And the Nevada companies signed a series of shorter-term contracts for specified quantities at fixed prices; most of the contracts were for a few months each, but two were two-year contracts. *Id.* at 79a & n.40.

The ALJ found that the purchasers were sophisticated institutions who "voluntarily chose the term[s]" of their contracts. Pet. App. 165a. For example, before signing its contract, Snohomish issued a request for proposals to 17 prospective sellers, and it received five bids in response. *Id.* at 162a-163a. One of the bids was from petitioner Morgan Stanley Capital Group, Inc. (Morgan

Stanley). *Id.* at 163a. Snohomish rejected that bid and requested another bid with different terms, which Morgan Stanley produced. *Id.* at 163a-164a. The parties then engaged in extensive negotiations, during which Snohomish was represented by counsel. *Id.* at 165a. Snohomish rejected several offers of shorter-term contracts at higher prices, insisting on a lower price, "even if the contract had to be for a longer term." *Ibid.* In other words, "it was Snohomish's choice" to lock in a rate below the then-prevailing market price and to "pass the risk of price volatility to the seller." *Id.* at 164a. As Snohomish explained to its customers at the time, the contract with Morgan Stanley provided it with "a lot of security against the uncertainty of market fluctuations." *Id.* at 166a.

SCWC similarly issued a request for proposals, received several bids in response, and engaged in negotiations with the seller. Pet. App. 168a-171a. Like Snohomish, SCWC "had available to it and actively explored a variety of resource options," *id.* at 174a, but it ultimately chose a long-term contract in order "to avoid price volatility by shifting the risks" of price increases (and the corresponding rewards of price decreases) to the seller, *id.* at 176a. Finally, the Nevada companies made their purchases through "routine and unremarkable broker trades." *Id.* at 161a. Their contracts were "at or below prevailing market prices." *Id.* at 160a-161a.

All of the contracts used the standard terms of the Western Systems Power Pool Agreement, with the duration, price, and quantity filled in by the parties. Pet. App. 80a-81a & n.46. That agreement, in use since 1991, provides for flexible pricing of transmission services and coordination of sales for the pool's more than 300 members. *Western Sys. Power Pool*, 119 F.E.R.C. ¶ 61,302,

at 62,690 (2007) (para. 5). The agreement contained a clause providing that "[n]othing contained herein shall be construed as affecting in any way the rights of the Parties to *jointly* make application to FERC for a change in the rates and charges" under 16 U.S.C. 824d. J.A. 1084a (emphasis added). It made no provision, however for a unilateral application for modification. In addition, the Snohomish contract stated that "[t]he rates for service specified in this Agreement * * * shall not be subject to change through application to FERC" under 16 U.S.C. 824d or 824e. Pet. App. 194a.

The ALJ recognized that the spot market for power was subject to dysfunction during the 2000-2001 energy crisis, Pet. App. 102a-108a, but she found no evidence "of specific manipulation by any [sellers] which impacted the forward markets generally or any contract at issue in this case specifically," *id.* at 137a. She also observed that forward prices and spot prices "can be expected to be linked only to the extent that spot markets summarize information from current supply and demand conditions which provide useful information on future supply and demand conditions." *Id.* at 118a. Thus, the ALJ concluded, the evidence showed that the rise and fall in forward prices "was in large part the result of market fundamentals or factors, other than 'dysfunction.'" *Id.* at 119a; see *id.* at 139a-140a.

The ALJ also found that the purchasers had failed to prove that the contracts had an adverse effect on their own financial health or on their customers. Pet. App. 209a-226a. Indeed, the ALJ noted that Snohomish had made millions of dollars in 2001 by reselling—at a higher price—some of the power it purchased from Morgan Stanley. *Id.* at 218a-219a. SCWC also profited by reselling some of the power it purchased. *Id.* at 215a.

Conversely, the ALJ determined that abrogation of the contracts would "erode investor confidence and willingness to invest in merchant energy projects," thereby impeding infrastructure development as well as causing "increased prices to compensate for increased risks." *Id.* at 179a.

After reviewing all of the evidence, the ALJ applied the "public interest" standard of *Mobile* and *Sierra*. Pet. App. 245a. She concluded that modification of the contracts was not warranted. *Ibid.*

b. After the ALJ issued her decision, the Commission staff released a report on manipulation in the western energy markets during the 2000-2001 energy crisis. Supp. J.A. 1sa-404sa (*Staff Report*). The report identified evidence of "significant market manipulation," *id.* at 17sa, and found that "prices in the California spot markets were affected by economic withholding and inflated bidding." *Id.* at 18sa. It did not find that there was manipulation in the forward market, but it used a statistical study to conclude that "forward power contracts negotiated during the period 2000–2001 in the western United States were influenced by then-current spot prices, presumably because spot power prices influenced buyers' and sellers' expectations of spot prices in the future." *Id.* at 190sa. The report also determined that "[t]he influence of spot prices on forward prices was the greatest for forward contracts with the shortest time to delivery (1-2 years) and varied by location." *Ibid.* Although the relationship was statistically significant, the report concluded that its magnitude was "limited," and "the impact of spot power prices on long term power prices is clearly not dollar-for-dollar." *Ibid.*

c. After hearing oral argument and considering the findings of the *Staff Report*, the Commission affirmed

the conclusions of the ALJ. J.A. 1222a-1323a. The Commission stated that, under the *Mobile-Sierra* doctrine, the purchasers "must demonstrate that the contracts in question are contrary to the public interest in order to support modification of the contracts." J.A. 1244a. The Commission concluded that the purchasers had failed to make such a showing, since they could not demonstrate "that the contracts in question caused financial distress," that the contracts "cast an excessive burden on their customers," or that "the contracts were unduly discriminatory to the detriment of other customers that were not parties to this proceeding." J.A. 1560a-1561a. The Commission denied petitions for rehearing. J.A. 1554a-1614a.

4. The purchasers petitioned for review, and the court of appeals granted the petitions. Pet. App. 1a-67a.

In the view of the court of appeals, while the "regulatory evolution" from cost-based to market-based rates did not "render *Mobile-Sierra* a dead letter," it nevertheless justified the court in creating new "prerequisites for [*Mobile-Sierra*'s] application in the present environment." Pet. App. 10a. According to the court, the *Mobile-Sierra* doctrine applies only when three conditions are met: (1) the terms of the contract must not preclude its application, *id.* at 37a; (2) "the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for initial review of the contracted rate," *id.* at 39a; and (3) "the scope of that review must permit consideration of the factors relevant to the propriety of the contract's formation," *id.* at 41a.

The court of appeals found the first prerequisite to be met, agreeing with the Commission that the contracts did not preclude application of the *Mobile-Sierra* doctrine. Pet. App. 46a. But the court held that FERC did

not have an opportunity for timely and effective review of rates. *Id.* at 51a. While market-based rate authority does provide a meaningful opportunity for prior review and approval of rates under the FPA, the court reasoned, it does so only insofar as FERC "implements and uses an effective oversight mechanism *after* the market-based rate authorization is initially granted." *Id.* at 48a-49a. The court found that FERC did not employ such a mechanism during the western energy crisis. *Id.* at 50a-51a. The court held that, having failed to provide effective oversight, FERC committed a "fundamental procedural error" in invoking the "public interest" standard under *Mobile-Sierra* as a ground for declining to undertake more extensive rate review, in abdication of its statutory responsibility to assure just and reasonable rates, including those contained in bilateral contracts. *Id.* at 57a.

Added to that "procedural error" was the Commission's "substantive adherence to *Mobile-Sierra* without regard to the market conditions in which the contracts at issue were formed." Pet. App. 57a. "*Mobile-Sierra* cannot apply," the court of appeals reasoned, "without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." *Ibid.* The court found that FERC failed to consider the effect of the widespread spot-market dysfunctions on the forward long-term contract market, the most important evidence of which was the FERC *Staff Report*. *Id.* at 57a-58a. The court held that, prior to applying *Mobile-Sierra* to the challenged contracts, the Commission was required to consider whether the influence of the spot markets on the forward markets reached a level suffi-

cient to question whether the contracts were just and reasonable when negotiated. *Id.* at 58a.

The court of appeals went on to state that, even if *Mobile-Sierra* applied, the Commission had used "an erroneous standard for determining whether the challenged contracts affect the public interest." Pet. App. 60a. Specifically, the court held that FERC had erroneously applied "factors taken from the context of a *low-rate* challenge rather than those relevant to the *high-rate* challenge presented in this case." *Id.* at 61a. FERC should instead have considered whether the contracts were "outside the 'zone of reasonableness' and result[ed] in retail rates higher than would be the case if that zone were not exceeded." *Id.* at 65a.

The court remanded to the Commission "to determine, first, whether *Mobile-Sierra* review of the challenged contracts is appropriate; second, if so, to apply the modified form of *Mobile-Sierra* review outlined in this opinion; and, finally, if not, to apply full just and reasonable review of the challenged contracts." Pet. App. 66a.

5. The sellers under the contracts at issue petitioned this Court for a writ of certiorari, arguing that the court of appeals had placed *Mobile* and *Sierra* "in the historical dustbin." 06-1457 Pet. 15. The Commission opposed certiorari, noting, *inter alia*, that the case involved application of "the principles of *Mobile* and *Sierra* to the highly unusual context of the 2000-2001 western energy crisis, the worst electricity-market crisis in American history." Br. in Opp. 12. On September 25, 2007, the Court granted a writ of certiorari.

SUMMARY OF ARGUMENT

The Federal Power Act requires that "rates and charges" for the sale of electric energy within the jurisdiction of the Federal Energy Regulatory Commission "shall be just and reasonable." 16 U.S.C. 824d(a). The statute confers broad discretion on FERC, and the Commission appropriately exercised that discretion in this case when it determined that the FPA does not authorize it to set aside long-term contracts for the sale of electric energy except in extraordinary circumstances where the contracts are contrary to the public interest. FERC's interpretation of the ambiguous statutory language is reasonable and should be upheld under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984).

The Commission's interpretation of the statute is consistent with this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956). In those cases, the Court recognized that the statute seeks to "preserv[e] the integrity of contracts" in order to promote "the stability of supply arrangements which all agree is essential." *Mobile*, 350 U.S. at 344. Even if the rate specified in a contract might be considered unjust and unreasonable if the Commission sought to impose it on a utility, the utility nevertheless may choose to agree to such a rate, and the Commission may modify it only if it "adversely affect[s] the public interest." *Sierra*, 350 U.S. at 355. That standard is a demanding one, satisfied only in extraordinary "circumstances of unequivocal public necessity." *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968).

As the Commission explained, the stability of contracts is even more essential today than it was when *Mobile* and *Sierra* were decided. In the modern era of

competitive energy markets, preserving the integrity of contracts is necessary to encourage investment in infrastructure. Modification of contracts, the Commission observed, will ultimately harm consumers by deterring investment and requiring increased prices to compensate suppliers for their increased risk.

The court of appeals erred in holding that the Commission was required to demonstrate effective oversight of market-based electricity rates, and to evaluate the potential effects of market dysfunction, before it could apply the principles of *Mobile* and *Sierra*. While the Commission recognizes the importance of appropriate oversight to the operation of the market-based rate regime—and has taken numerous steps to enhance that oversight since the events giving rise to this case—any perceived deficiency in that oversight is not by itself a basis on which to set aside a valid contract. Likewise, although market dysfunction is certainly relevant to whether the public interest requires contract modification, it is not, by itself, a reason to set aside a contract. Here, the Commission found that there was dysfunction in the spot markets, but that no dysfunction or manipulation occurred in the forward market in which these contracts were signed.

Finally, the Commission correctly applied the "public interest" standard to the facts of this case. The Commission determined that the purchasers were sophisticated entities who voluntarily agreed to long-term, fixed-price contracts even though they had other options available to them. In so doing, they guaranteed that they would be protected in the event that prices rose. They should not be relieved from their agreements simply because prices happened to fall and therefore, with

the benefit of hindsight, they appear to have made an "improvident bargain." *Sierra*, 350 U.S. at 355.

ARGUMENT

THE FEDERAL ENERGY REGULATORY COMMISSION REASONABLY DETERMINED THAT THE FEDERAL POWER ACT DID NOT REQUIRE THAT THE CONTRACTS AT ISSUE IN THIS CASE BE SET ASIDE

A. The Commission Reasonably Interpreted The Federal Power Act To Provide For Only Limited "Public Interest" Review Of The Rates Set By The Contracts

The Commission reasonably interpreted 16 U.S.C. 824d and 824e to provide for a narrow review of the rates set by the contracts at issue in this case—a review that is limited to determining whether the rates are contrary to the public interest. The Commission also reasonably determined that the contract rates should not be set aside under that standard.

The court of appeals erred in rejecting the Commission's interpretation and application of the relevant statutory provisions in the particular circumstances of this case. As an initial matter, the court of appeals failed to appreciate that FERC's construction of Sections 824d and 824e is entitled to deference under *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984). In all events, under any standard of review, the Commission's reading of the statute—a reading that, in contrast to the court of appeals' approach, is faithful to this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956)—should be upheld.

1. The Commission's interpretation of the Federal Power Act is entitled to deference

In deciding whether it was appropriate to modify the contracts at issue in this case, the Commission had to determine whether the rates set by the contracts were "unjust, unreasonable, unduly discriminatory or preferential" under 16 U.S.C. 824e(a). See 16 U.S.C. 824d(a) ("All rates and charges * * * shall be just and reasonable."). The Commission explained that, in applying the statutory requirement that rates be "just and reasonable," "the applicable standard of review for the contracts at issue here is the 'public interest' standard" identified in this Court's decisions in *Mobile* and *Sierra*. J.A. 1225a. FERC's interpretation of Sections 824d and 824e was reached in a formal adjudication and is entitled to deference under *Chevron*. See *United States* v. *Mead Corp.*, 533 U.S. 218, 229 (2001).

Neither Section 824d nor Section 824e speaks directly "to the precise question at issue" in this case. *Chevron*, 467 U.S. at 842. Under the "just and reasonable" standard, the Commission is not "bound to the use of any single formula." *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944); see *ibid.* (The Commission's application of the standard "is the product of expert judgment which carries a presumption of validity."). Just last Term, in considering analogous provisions of the Communications Act of 1934, this Court held that *Chevron* deference was owed to the Federal Communications Commission's interpretation and application of a statutory prohibition against "unjust or unreasonable" practices. See *Global Crossing Telecomms., Inc.* v. *Metrophones Telecomms., Inc.*, 127 S. Ct. 1513, 1522 (2007) (construing 47 U.S.C. 201(b)); see also *Capital Network Sys., Inc.* v. *FCC*, 28 F.3d 201, 204 (D.C. Cir. 1994) (not-

ing that "'just,' 'unjust,' 'reasonable,' and 'unreasonable' are ambiguous statutory terms"). FERC's interpretation must therefore be upheld so long as it represents "a permissible construction of the statute." *Chevron*, 467 U.S. at 843.

Indeed, in *Sierra*, after concluding that the Act required application of the "public interest" standard in determining whether the contract rates were "just and reasonable," the Court held that the question whether, under the facts of that case, the rates there at issue were contrary to the public interest "is of course a question to be determined by the Commission in the first instance." 350 U.S. at 355; cf. *FCC* v. *RCA Commc'ns, Inc.*, 346 U.S. 86, 90 (1953) (describing the "public interest, convenience, or necessity" standard of the Radio Act of 1927, ch. 169, § 4, 44 Stat. 1163, as "[n]ot a standard that lends itself to application with exactitude," but one that "leaves wide discretion and calls for imaginative interpretation"); *Mistretta* v. *United States*, 488 U.S. 361, 416 (1989) (Scalia, J., dissenting) (pointing to the "public interest" standard as an example of the breadth of scope for permissible delegation).

2. The Commission's application of the Act's "just and reasonable" requirement represents a reasonable interpretation of the Federal Power Act

The court of appeals was correct to observe that "there is but one statutory standard addressing the lawfulness of wholesale electricity rates," and "[t]hat standard requires that *all* rates be 'just and reasonable.'" Pet. App. 35a. But simply because the "just and reasonable" standard governs all rates, it does not follow that it applies in the same way in every context. The FPA "expressly recognizes that rates to particular customers

may be set by individual contracts." *Mobile*, 350 U.S. at 338. To effectuate the statutory interest in allowing rates to be set by contract, the Commission reasonably concluded, consistent with *Mobile* and *Sierra*, that when a party challenges a rate set by a contract to which it has agreed, it bears a higher burden than it would if it were challenging a non-contract rate. In particular, in order to set aside a contract rate, a party must demonstrate that the rate will "adversely affect the public interest." J.A. 1226a (quoting *Sierra*, 350 U.S. at 355). That standard is satisfied only in "circumstances of unequivocal public necessity." *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968) (*Permian Basin*); accord *Arkansas La. Gas Co.* v. *Hall*, 453 U.S. 571, 582 (1981) (Commission may "'abrogate existing contractual arrangements'" only in "extraordinary circumstances") (quoting *Permian Basin*, 390 U.S. at 820); see *Wisconsin Pub. Power, Inc.* v. *FERC*, 493 F.3d 239, 271 (D.C. Cir. 2007) (per curiam) ("The public interest standard is much more restrictive" than the standard applicable "to rates not contractually shielded.") (internal quotation marks and citation omitted); see pp. 38-39, *infra*.

The Commission's approach was fully consistent with this Court's precedents. As the Court has explained, the line of cases beginning with *Mobile* and *Sierra* rests on the recognition that "[i]n wholesale markets, the party charging the rate and the party charged [are] often sophisticated businesses enjoying presumptively equal bargaining power who [can] be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon Commc'ns Inc.* v. *FCC*, 535 U.S. 467, 479 (2002). Accordingly, when a willing buyer and a willing seller agree upon a rate, "the principal regulatory responsibility [is] not to relieve a contracting party of an unreason-

able rate, * * * but to protect against potential discrimination by favorable contract rates between allied businesses to the detriment of *other* wholesale customers." *Ibid.* (emphasis added). In other words, the Commission must consider not whether the rate is disadvantageous to the interests of one of the contracting parties, but whether it will "adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other customers an excessive burden, or be unduly discriminatory." *Sierra*, 350 U.S. at 355.

In *Sierra* itself, the Court observed that while "a rate which would produce less than a fair return" might not be considered "just and reasonable" if the Commission sought to impose it on a utility, a utility is not prohibited from agreeing by contract to accept such a rate. 350 U.S. at 355. In that context, such a rate must be regarded as just and reasonable, and the utility would not be "entitled to be relieved of its improvident bargain" by Commission action under Section 824e just because the rates to which the seller agreed are too low. Instead, the rates are upheld unless they are found to be contrary to the "public interest." *Ibid.* The same general principle applies here, where purchasers complain that the rates to which they agreed are too high.

The courts of appeals have consistently applied *Mobile* and *Sierra* in reviewing the Commission's treatment of rates set by contract. See, *e.g.*, *Boston Edison Co.* v. *FERC*, 233 F.3d 60, 64-69 (1st Cir. 2000); *Potomac Elec. Power Co.* v. *FERC*, 210 F.3d 403 (D.C. Cir. 2000); *San Diego Gas & Elec. Co.* v. *FERC*, 904 F.2d 727, 730 (D.C. Cir. 1990). In so doing, they have recognized that the *Mobile-Sierra* doctrine promotes the important interest in the stability of contracts. See *Potomac Elec. Power*

Co., 210 F.3d at 409 ("The court has repeatedly emphasized the importance of contractual stability in a number of cases involving the *Mobile-Sierra* doctrine."); see also *Boston Edison Co.* v. *FERC*, 856 F.2d 361, 372 (1st Cir. 1988). As this Court has explained, "[b]y preserving the integrity of contracts," the *Mobile-Sierra* doctrine "permits the stability of supply arrangements which all agree is essential to the health of the natural gas industry." *Mobile*, 350 U.S. at 344.

The interest in "[p]reservation of contracts has, if anything, become even more critical" since *Mobile* and *Sierra* were decided. *PacifiCorp*, 99 F.E.R.C. ¶ 61,381, at 62,614 (2002). FERC has explained that it seeks to "protect[] customers * * * by providing rate stability through the protection of sales contracts." *CARE*, 119 F.E.R.C. ¶ 61,058, at 61,249 (2007). Conversely, failing to protect contracts would "harm customers by reducing the willingness of sellers and buyers to contract for rate certainty through fixed-rate contracts or by deterring sellers and buyers from making the investment needed to support the long-term contracts." *Ibid.*

Indeed, in the order at issue here, the Commission found that "contract modification will harm credit and investor confidence by altering the perception of a formerly stable cash flow into an undependable, risky cash flow." J.A. 1260a-1261a. That instability would reduce the willingness of investors "to invest in merchant energy contracts, which, in turn, could have an adverse effect on infrastructure development, especially at a time when Western markets need new generation and transmission." *Ibid.*; see *PacifiCorp*, 99 F.E.R.C. ¶ 61,381, at 62,614 ("Competitive power markets simply cannot attract the capital needed to build adequate generating infrastructure without regulatory certainty,

including certainty that the Commission will not modify market-based contracts unless there are *extraordinary* circumstances."). In addition, contract modification could harm consumers because it would "result in increased prices to compensate for increased risks." J.A. 1261a. The Commission appropriately took those considerations into account in determining—in accord with this Court's decisions in *Mobile* and *Sierra*—that the FPA calls for an inquiry focused on the "public interest" in reviewing rates set by contract. Because FERC's order rested on a reasonable interpretation of the ambiguous language of the FPA, it should have been upheld.

B. The Court Of Appeals Erred In Creating New "Prerequisites" For The Application Of *Mobile* And *Sierra*

The court of appeals set aside the Commission's determination that the "public interest" standard under *Mobile-Sierra* applies in this case. That ruling by the court was erroneous. According to the court of appeals, "*Mobile* and *Sierra* arose in a regulatory context in which there was an opportunity for traditional cost-based just and reasonable rate review before the energy contracts at issue became effective." Pet. App. 9a. Noting that the modern regulatory regime embraces market-based rates, the court concluded that the *Mobile-Sierra* doctrine should be modified by the addition of three "prerequisites" for its application. *Id.* at 10a-11a. Specifically, the court held that in order for the *Mobile-Sierra* doctrine to be applied, (1) the contract by its own terms must not preclude *Mobile-Sierra* review; (2) the regulatory scheme in which the contracts are formed must provide FERC with an opportunity for effective, timely review of the contracted rates; and (3) where

FERC has permitted market-based rates, its review must permit consideration of all factors relevant to the propriety of the contract's formation. *Id.* at 10a.

The first of these "prerequisites" does not represent a modification of *Mobile-Sierra* or a departure from the Commission's practice, since this Court has long recognized that contracting parties may, if they wish, opt out of *Mobile-Sierra* by specifying that rates shall be subject to modification. See *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958) (*Memphis*). The court's imposition of the other two prerequisites, however, was inappropriate. That is true whether the *Mobile-Sierra* doctrine is conceptualized as an application of normal principles of review of administrative action or as binding Supreme Court case law, and, of course, it is both. As to the former, nothing in the Act compels the two prerequisites the court advanced, and the court of appeals had no basis for substituting its judgment for that of the Commission on the question whether the public interest standard under the FPA applies. And, as to the latter, to the extent the court of appeals believed that changes in "the historical and regulatory context," Pet. App. 11a, require that the application of this Court's decisions in *Mobile* and *Sierra* should themselves be "limited," *id.* at 37a, that is not the role of the court of appeals. Cf. *Rodriguez de Quijas* v. *Shearson/Am. Express, Inc.*, 490 U.S. 477, 484 (1989). Courts of appeals are generally not free to erect "prerequisites" for the application of binding Supreme Court precedent. Cf. *Tenet* v. *Doe*, 544 U.S. 1, 8-11 (2005) (rejecting effort to "recast" Supreme Court precedent and citing *Rodriguez de Quijas*). In any event, even—indeed, especially—in the modern era of market-

based rates, there is no justification for the novel requirements imposed by the court below.

1. The Mobile-Sierra *doctrine does not require* ex ante *oversight of rates set by contract*

The court of appeals held that "although market-based rate authority *can* qualify as sufficient prior review to justify limited *Mobile-Sierra* review, it can only do so when accompanied by effective oversight permitting timely reconsideration of market-based authorization if market conditions change." Pet. App. 46a. Under the court's test, the "crucial question" is whether FERC provided "sufficient oversight for contracts made under market-based rate authority to ensure that the resulting rates were within the statutory 'just and reasonable' range in the first instance, thereby permitting reliance on the *Mobile-Sierra* doctrine as to the continuing effectiveness of those contracts" *Id.* at 51a. That test represents both an unwarranted intrusion into the agency's judgments about how to adjust its regulatory scheme to account for market-based rates and an unjustified departure from the principles announced by this Court in *Mobile* and *Sierra* concerning the application of the Act's "just and reasonable" standard to rates set by contract. Certainly nothing in the Act, the Commission's approval of market-based rates, or this Court's decisions *required* the Commission to impose those prerequisites.

a. As an initial matter, the court of appeals was correct to recognize that the market-based rate regime is consistent with the Federal Power Act. Pet. App. 47a. "In competitive markets, FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a just and reasonable result." *Consumers Energy Co.* v. *FERC*, 367 F.3d 915, 922-923 (D.C. Cir. 2004)

(Roberts, J.) (internal quotation marks and citation omitted); see *Elizabethtown Gas Co.* v. *FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993); *Tejas Power Corp.* v. *FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990). The Ninth Circuit had previously upheld the Commission's market-based rate approach in *California ex rel. Lockyer* v. *FERC*, 383 F.3d 1006, 1011-1013 (9th Cir. 2004), and the Court denied review of that holding, 127 S. Ct. 2972 (2007). The Ninth Circuit's reiteration of that holding in this case is not challenged here. See Snohomish Br. in Opp. 26.

While 16 U.S.C. 824d(a) requires that "[a]ll rates and charges made * * * shall be just and reasonable," the FPA does not dictate, or even mention, any particular ratemaking methodology to be followed. Thus, the FPA grants FERC broad discretion as to how the statute's ratemaking mandate will be satisfied. The market-based rate program represents a reasonable exercise of that discretion.

Although the FPA requires that every public utility file with FERC "schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission," 16 U.S.C. 824d(c), it explicitly leaves the timing and form of those filings to FERC's discretion. Public utilities must file "schedules showing all rates and charges" under "such rules and regulations as the Commission may prescribe," and "within such time and in such form as the Commission may designate." *Ibid.* The FPA does not define "schedules," leaving that to FERC's discretion as well. See 18 C.F.R. 35.2(b). Accordingly, as the Ninth Circuit observed in *Lockyer*, "so long as FERC has approved a tariff within the scope of its FPA authority, it has broad discretion to establish effective reporting require-

ments for administration of the tariff." 383 F.3d at 1013. The Commission has done just that by requiring periodic reporting of transactions that take place under a market-based rate tariff. See *ibid.*; see 18 C.F.R. 35.10b.

Had there been any doubt about the validity of market-based rates, it should have been dispelled by the enactment of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005 Act). Several provisions of that statute are premised on the existence of the market-based rate system and are aimed at enhancing that system and ensuring its smooth functioning. For example, Congress adopted a prohibition on "market manipulation" that is modeled on the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.* See 2005 Act § 1283, 119 Stat. 979 (16 U.S.C. 824v (Supp. V 2005)) (making it unlawful "to use or employ, in connection with the purchase or sale of electric energy or the purchase or sale of transmission services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance," and incorporating the definitions of those terms in 15 U.S.C. 78j(b)). The prohibition on market manipulation presupposes the existence of market transactions.

In another provision of the 2005 Act, Congress directed FERC to adopt rules "to facilitate price transparency in markets for the sale and transmission of electric energy" and "to ensure that consumers and competitive markets are protected from the adverse effects of potential collusion or other anticompetitive behaviors" and from "untimely public disclosure of transaction-specific information." 2005 Act § 1281(a)(1) and (b)(2), 119 Stat. 978-979 (16 U.S.C. 824t(a)(1) and (b)(2) (Supp. V 2005)); see § 1286, 119 Stat. 981 (16 U.S.C. 824e(e)(2) (Supp. V

2005)) (giving FERC new "refund authority" over entities otherwise not subject to FERC's jurisdiction that make "short-term sale[s] of electric energy through an organized market in which the rates for the sale are established by Commission-approved tariff"); § 1290, 119 Stat. 984 (enhancing the Commission's remedial authority in cases where it has "revoked the seller's authority to sell any electricity at market-based rates"). In all of these provisions, Congress has "effectively ratified the [Commission's] previous position" regarding its authority to approve a framework of market-based rates under the FPA. *FDA* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 156 (2000). Moreover, such efforts to improve the functioning of the market-based system *directly* are far superior to efforts to condition the availability of deference and the applicability of Supreme Court precedent on the nature and timing of Commission review.

b. The court of appeals was also correct that "oversight," Pet. App. 51a, is an important part of the market-based rate program. In *Lockyer*, the Ninth Circuit held that, in addition to making a finding of a lack of market power, the Commission must engage in ongoing monitoring of markets to detect whether a seller subsequently obtains market power or otherwise manipulates markets. 383 F.3d at 1014. As the court in *Lockyer* noted, "FERC's system consists of a finding that the applicant lacks market power (or has taken sufficient steps to mitigate market power), coupled with strict reporting requirements to ensure that the rate is 'just and reasonable' and that markets are not subject to manipulation." *Id.* at 1013.

Under the market-based rate regime, there is an opportunity for a hearing in response to an application

for authorization of market-based pricing. The burden of proof is on the applicant to show that it lacks, or has adequately mitigated, market power. See generally 18 C.F.R. Pt. 35 (filing requirements and procedures). That investigation satisfies 16 U.S.C. 824d(d), which requires that all rates be filed 60 days before service begins, and 16 U.S.C. 824d(e), which permits suspension and investigation of proposed rates before they are charged. In addition, if an applicant is granted market-based rate authority, it must file quarterly reports showing transaction-specific data for all transactions. See 18 C.F.R. 35.10b.

Moreover, since the events giving rise to this case, the Commission's ability to monitor markets and prosecute manipulation has been greatly enhanced. As noted, the Energy Policy Act of 2005 has given FERC new authority to remedy manipulative behavior by participants in wholesale electricity markets, including the authority to impose increased civil penalties for violations of the FPA. 2005 Act § 1284(e), 119 Stat. 980 (16 U.S.C. 825*o*-1 (Supp. V 2005)). In addition, the Commission has taken a series of steps "to ensure that there are appropriate market safeguards in place to prevent a repeat of the California 2000-2001 energy crisis." *CARE*, 119 F.E.R.C. ¶ 61,058, at 61,247. For example, the Commission has created an expanded office to oversee markets, has adopted new rules to limit the potential for market manipulation, and has revised its program for evaluating requests for market-based rates. See *Market-Based Rates*, 119 F.E.R.C. ¶ 61,295, at 62,653 (2007), petition for reh'g pending.[3] As the Commission

[3] See also, *e.g.*, *Revised Pub. Util. Filing Requirements*, 99 F.E.R.C. ¶ 61,107, at 61,480 (2002) (Order No. 2001) (requiring electronic filing of quarterly reports providing transaction-specific data on wholesale

has explained, the "improved market-based rate program provides the foundation to ensure that sellers and buyers can continue to rely on market-based rate contracts to provide price certainty, flexibility in contract terms, and the contract stability necessary to support new investment." *CARE*, 119 F.E.R.C. ¶ 61,058, at 61,249.

c. Although effective oversight is an important part of ensuring that the requirements of Section 824d are satisfied in the context of market-based rates, the court of appeals erred in holding that a particular form of

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power sales) (67 Fed. Reg. 31,044 (2002)), orders on reh'g, 100 F.E.R.C. ¶ 61,074, at 61,284, and 100 F.E.R.C. ¶ 61,342, at 62,555 (2002); *Investigation of Terms and Conditions of Pub. Util. Market-Based Rate Authorizations*, 105 F.E.R.C. ¶ 61,218, at 62,141 (2003) (imposing market behavioral rules in all market-based rate tariffs), order on reh'g, 107 F.E.R.C. ¶ 61,175, at 61,702 (2004), aff'd *sub nom. Colorado Office of Consumer Counsel* v. *FERC*, 490 F.3d 954 (D.C. Cir. 2007); *Electric Quarterly Reports*, 105 F.E.R.C. ¶ 61,219, at 62,174 (2003) (revoking market-based rate authority for utilities that failed to meet reporting requirements); *3E Techs., Inc.*, 113 F.E.R.C. ¶ 61,124, at 61,496 (2005) (same); *AEP Power Mktg., Inc.*, 107 F.E.R.C. ¶ 61,018, at 61,048 (adopting new interim generation market-power analysis and mitigation policy), on reh'g, 108 F.E.R.C. ¶ 61,026, at 61,110 (2004); *Reporting Requirement for Changes in Status for Pub. Utils. with Market-Based Rate Auth.*, 110 F.E.R.C. ¶ 61,097, at 61,401 (2005) (Order No. 652) (amending regulations to establish a reporting obligation for changes in status that apply to public utilities authorized to make sales at market-based rates) (70 Fed. Reg. 8253 (2005)); *Prohibition of Energy Market Manipulation*, 114 F.E.R.C. ¶ 61,047, at 61,128 (2006) (Order No. 670) (amending Commission regulations to implement new Section 222 of the Federal Power Act, 16 U.S.C. 824v (Supp. V 2005), prohibiting the employment of manipulative or deceptive devices or contrivances) (71 Fed. Reg. 4244 (2006)); *Standards of Conduct for Transmission Providers*, 118 F.E.R.C. ¶ 61,031, at 61,170 (2007) (proposing revised standards of conduct for electric transmission providers) (72 Fed. Reg. at 3958).

oversight is a precondition to the application of the public interest standard for determining whether contract rates are just and reasonable under the FPA and this Court's decisions in *Mobile* and *Sierra*. Where, as here, the basic framework for approving market-based rates has been sustained and is no longer challenged, that framework must be taken as a given in assessing the validity of rates established in contracts entered into under that regime. The point is not that the market-based system cannot be improved—both Congress and the Commission have taken steps to improve the process based on the lessons learned from the 2000-2001 western energy crisis. The point is that efforts to improve the system should be made *directly*, not as a precondition for the application of *Mobile-Sierra*. An imperfection in the Commission's market oversight, standing alone, is not a sufficient basis to set aside a contract that would otherwise qualify for protection under the FPA.

Contrary to the apparent assumption of the court of appeals, *Mobile* and *Sierra* do not apply only in cases where the Commission has reviewed the contracted-for rate at the time of the contract and determined it to be just and reasonable. Indeed, the orders in *Mobile* and *Sierra* made clear that the Commission had *not* made a full evaluation of the reasonableness of the rates at the time the contracts in those cases were signed. See *United Gas Pipe Line Co.*, 5 F.P.C. 770 (1946) (accepting the *Mobile* contract for filing, and stating that "[n]othing contained in this order shall * * * be construed as constituting approval by this Commission of any service, rate, charge, classification, or any rule, regulation, contract or practice"); *Pacific Gas & Elec. Co.*, 7 F.P.C. 832 (1948) (accepting the *Sierra* contract for filing, with the same reservation); see also 18 C.F.R.

35.4 ("The fact that the Commission permits a rate schedule or any part thereof or any notice of cancellation to become effective shall not constitute approval by the Commission of such rate schedule or part thereof or notice of cancellation."). Neither the FPA nor this Court's decisions in *Mobile* and *Sierra* require the Commission to examine the contracted-for rate negotiated under a prior FERC approval of general market-based rate authority, because "sophisticated businesses enjoying presumptively equal bargaining power [can] be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon Commc'ns, Inc.*, 535 U.S. at 479.

More importantly, it would be impossible for *any* initial review of rates to guarantee that the approved rates would remain just and reasonable for all time. Under Section 824d, a utility has the burden to show initially that its rates—whether cost-based or market-based—will be just and reasonable. For market-based rates, that determination must be made before the authorization for market-based rates is granted. J.A. 1567a. But whether the rates are market-based or cost-based, any initial determination of their justness and reasonableness can only be based on the factual circumstances existing at the time, and those circumstances can change. See *B.C. Power*, 99 F.E.R.C. ¶ 61,247, at 62,064 & n.39, reh'g denied, 100 F.E.R.C. ¶ 61,295, at 62,328 (2002), review granted *sub nom. Lockyer*, 383 F.3d 1006 (9th Cir. 2004), cert. denied, 127 S. Ct. 2972 (2007).

In addition, even with the Commission's new statutory and regulatory tools, government oversight of markets can never be perfect. There will inevitably be situations in which a seller evades detection and is later

found to have acquired market power or manipulated markets. In such circumstances, the primary remedy is to revoke market-based rate authority, see *B.C. Power*, 99 F.E.R.C. ¶ 61,247, at 62,065, order disgorgement of profits if the seller's conduct constituted a violation of a tariff or FERC regulations or orders, see 16 U.S.C. 825h, or impose civil penalties, see 16 U.S.C. 825*o*-1 (Supp. V 2005), not to abrogate contracts, especially contracts other than those to which the offending seller was a party. That final step is appropriate only if the contracts threaten the public interest. The fundamental point of the interpretation of the term "just and reasonable" in the FPA under *Mobile* and *Sierra*, after all, is that a change in circumstances is insufficient to warrant modification of a contract unless it is so serious as to threaten the public interest. Cf. *Sierra*, 350 U.S. at 351-352 (describing changes in the availability of power to the seller in that case).

The test adopted by the court of appeals is thus at odds with the fundamental statutory interest in preserving the "integrity of contracts" and "the stability of supply arrangements." *Mobile*, 350 U.S. at 343-344. That stability would be undermined if contracting parties could not be certain, at the time of contracting, what legal regime will govern their contracts. And under the court's test, it would always be possible that a regulatory regime would be determined, with the benefit of hindsight, to have provided an inadequate opportunity for oversight, thus requiring the Commission to set aside the contract and conduct a *de novo* "just and reasonable" review to set the rate. Pet. App. 66a. The Act does not specify any such test, and the Commission was not required to adopt it.

2. *A finding of "market dysfunction," although relevant to the application of the public interest standard, does not render that standard altogether inapplicable*

For similar reasons, the court of appeals erred in holding that "*Mobile-Sierra* cannot apply without a determination that the challenged contract was initially formed free from the influence of improper factors, such as market manipulation, the leverage of market power, or an otherwise dysfunctional market." Pet. App. 57a. According to the court, the Commission had failed to make the requisite determination, because it did not "consider whether the influence of the spot markets on the forward markets reached a level sufficient to question whether FERC could assume that two private parties had negotiated a 'just and reasonable' contract in the first instance and therefore apply the *Mobile-Sierra* presumption." *Id.* at 58a-59a. But while the Commission declined to consider market dysfunction in determining whether to *invoke* the public interest standard of review, it did consider that evidence as one factor in determining whether the public interest standard had been *satisfied*. J.A. 1274a-1276a, 1284a-1286a.

Essentially, the court of appeals concluded that the Commission considered market dysfunction at the wrong stage of its analysis. The court appeared to contemplate a two-phase inquiry in which the Commission first considers the factors relevant to contract *formation*, Pet. App. 57a-60a, and then, if the *Mobile-Sierra* test applies, considers factors relevant to the rate *effects* of the contracts, such as the impact of the contract on consumers, *id.* at 60a-65a. The Commission's approach, however, was reasonable and consistent with *Mobile* and *Sierra*, and nothing in the Act or those decisions requires the bifurcated inquiry announced by the court.

Cf. *Mobil Oil Exploration & Producing Se., Inc.* v. *United Distribution Cos.*, 498 U.S. 211, 230 (1991) (noting that an "agency enjoys broad discretion in determining how best to handle related, yet discrete, issues in terms of procedures * * * and priorities"); *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519 (1978).

Not every instance of market power, manipulation, or dysfunction will merit contract abrogation. Some may have little connection to contract formation; others may be closely connected. Some may have little impact on consumers; others may have a significant impact on consumers. Some contracts may easily be abrogated without unfair impact on parties uninvolved in the manipulation; others may not. The court of appeals was therefore incorrect to hold that unless a contract is formed completely "free from the influence of improper factors," then "*Mobile-Sierra* cannot apply." Pet. App. 57a. Like the court's holding that the application of the public interest standard of review of contract rates turns on the degree of oversight by FERC, this aspect of the Court's decision undermines the integrity of contracts and introduces substantial uncertainty by making it difficult for parties to know whether the rates in their contracts will be set aside in favor of new rates determined to be "just and reasonable" after a *de novo* inquiry by the Commission.

Accordingly, while the considerations identified are relevant to the public interest inquiry under *Mobile-Sierra*, elevating them to the status of preconditions for even reaching the ordinary public interest inquiry introduces uncertainty while diverting the focus from a proper inquiry into the contract's effect on the public interest.

C. The Commission Properly Applied The Public Interest Standard To Uphold The Contracts At Issue Here

FERC correctly applied the "public interest" standard of *Mobile* and *Sierra* in declining to set aside the contracts at issue here. Although the court of appeals faulted the Commission for applying principles relevant to a "low rate" case even though the purchasers in this case were challenging high rates, the Commission reasonably interpreted the "public interest" standard to impose a parallel burden on buyers and on sellers who seek the modification of contracts that they have signed. That burden is a heavy one, and the Commission reasonably determined, based on its examination of the totality of the circumstances, that the purchasers failed to carry it.

1. The "public interest" standard permits modification of contracts only in extraordinary circumstances

The "public interest" standard for reformation of contracts under the *Mobile-Sierra* doctrine is satisfied only in extraordinary "circumstances of unequivocal public necessity." *Permian Basin*, 390 U.S. at 822. As the courts of appeals have recognized, the standard is "much more restrictive" than that governing rates not set by contract. *Atlantic City Elec. Co.* v. *FERC*, 295 F.3d 1, 14 (D.C. Cir. 2002); accord *Potomac Elec. Power Co.*, 210 F.3d at 407. For example, "FERC cannot order an increase in a contracted-for rate merely by finding that the rate is unreasonably low in the traditional sense that it is insufficient to produce a reasonable return on capital for the seller." *Boston Edison Co.*, 233 F.3d at 65; see *Northeast Utils. Serv. Co.* v. *FERC*, 993 F.2d 937, 960 (1st Cir. 1993) (The public interest standard is "a more difficult standard for the Commission to meet"

than the standard applicable in cases not involving a contract.).

In *Sierra*, this Court offered, as examples of a situation that would satisfy the "public interest" test, the case of a rate so low that it would "impair the financial ability of a public utility to continue service" or "cast upon other consumers an excessive burden." 350 U.S. at 355. The Commission cited that example in its order, J.A. 1226a, and it reasonably interpreted the "public interest" standard to require a showing of harm of comparable severity before contract reformation would be justified.

2. The court of appeals erred in suggesting that the "public interest" standard applies differently in "high rate" cases than in "low rate" cases

The court of appeals held that FERC erred in relying on the statement in *Sierra* that the rate in a contract might "adversely affect the public interest" if it "cast upon other consumers an excessive burden." 350 U.S. at 355. The "excessive burden" standard, the court of appeals suggested, is applicable only in a "low rate" case where a seller seeks a rate increase. Pet. App. 66a. In a "high rate" case such as this one, where the buyer seeks a rate decrease, the court held that the appropriate standard is whether the customer's electric bills were "higher than they otherwise would have been had the challenged contracts called for rates within the just and reasonable range." *Id.* at 64a.[4] That standard was

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[4] The one aspect of the *Sierra* language that is inapplicable in shifting from a case where a seller complains that the rate is too low to a case where the buyer complains that the rate is too high is the Court's reference to excessive burdens on "other consumers," because in the "high rate" case the concern will be whether the buyer's custom-

intended by the court of appeals to "mirror[] that endorsed by the D.C. Circuit for determination of a just and reasonable rate under a market-based rate regime." *Id.* at 65a (citing *Interstate Natural Gas Ass'n of Am.* v. *FERC*, 285 F.3d 18, 31-36 (D.C. Cir. 2002)).

The court of appeals failed to appreciate that the same public interest standard protects both buyers and sellers, and that it applies in both "high rate" cases and "low rate" cases. See *Potomac Elec. Power Co.*, 210 F.3d at 406, 410 (applying *Sierra* public interest factors in a case where rates were allegedly too high). It is "logically inferable" that both sellers and purchasers "can make bargains which in hindsight prove improvident," *Boston Edison Co.*, 856 F.2d at 372, and the FPA contains no provisions affording special protections to improvident buyers. Thus, "[e]xcept as the exigencies of the public interest demand[]," FERC is "no more at liberty to alter the * * * contract to the prejudice of the [sellers] than to do so in their favor." *Public Serv. Comm'n* v. *FPC*, 543 F.2d 757, 798 (D.C. Cir. 1974); see *Boston Edison Co.*, 856 F.2d at 372 ("In our view, the policies enunciated by Congress are in no way demeaned by requiring primary energy distributors and their wholesale customers alike to exercise reasonable self-interested vigilance and to act promptly to protect their respective positions.").

It is not entirely clear to what extent the court of appeals departed from these principles. On the one hand, the court stated that even a "small dent in the customer's pocket" can implicate the public interest, Pet.

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ers—and not the other consumers whose power comes from the seller—suffer an excessive burden. But beyond that necessary accommodation, there is no reason to substitute some less demanding and more ambiguous standard for the excessive-burden test.

App. 64a (quoting *FPC* v. *Texaco Inc.*, 417 U.S. 380, 399 (1974)), and it suggested that in "high rate" cases, the public interest standard is equivalent to the ordinary just and reasonable standard as it is applied in cases not involving a contract. *Id.* at 65a. For example, it held that "a high-rate public interest determination should focus on whether consumers' electricity bills have been affected by the challenged rates—not necessarily whether the electricity bills have increased since the signing of the contracts, but whether those bills are higher than they would otherwise have been had the challenged contracts called for rates within the just and reasonable range." *Id.* at 64a; see *id.* at 65a. On the other hand, the court acknowledged that "the stability of contract considerations that underlie the *Mobile-Sierra* doctrine do carry over to challenges by buyers rather than sellers." *Id.* at 63a. It also cautioned that it did not mean "to say that *any* direct impact on consumer rates is enough to demonstrate a public interest effect sufficient to displace the countervailing *Mobile-Sierra* concern with protecting the stability of contract." *Id.* at 64a.

The court of appeals was correct that, as a factual matter, "[t]he concerns in * * * a high-rate case are not entirely parallel to those in a low-rate case." *Id.* at 62a-63a. As the First Circuit has noted, the *Sierra* "definition of what is necessary in the public interest was formulated in the context of a *low-rate* case. It was not and could not be an across-the-board definition of what constitutes the public interest in other types of cases." *Northeast Utils. Serv. Co.* v. *FERC*, 55 F.3d 686, 690 (1st Cir. 1995). For example, the insolvency of a seller is obviously an issue in a low rate case, see *Sierra*, 350 U.S. at 355, but insolvency is not necessarily a con-

cern in a high rate case, such as where a purchaser can pass high rates on to its customers without going bankrupt.

Even though the factual considerations relevant to a high rate case may differ from those relevant to a low rate case, there is no reason to conclude that the governing legal standard should be any different in the two cases. See note 4, *supra*. Both buyers and sellers "can make bargains which in hindsight prove improvident," *Boston Edison Co.*, 856 F.2d at 372, and therefore both buyers and sellers who benefit from changed circumstances need protection from remorseful counterparties, subject to the Commission's ultimate authority to protect the public interest in extraordinary cases, but not subject to routine second-guessing in the courts. Sellers need certainty to make investment and hedging decisions; purchasers need certainty to provide rate stability and protect their procurement decisions. The distinction between "high rate" cases and "low rate" cases provides no basis for overturning the Commission's order in this case.

3. The Commission reasonably concluded that the public interest does not require modification of the contracts at issue here

Based on its examination of the totality of the circumstances, the Commission determined that the public interest did not call for the reformation of the contracts at issue in this case. J.A. 1228a. The factual findings underlying that determination were supported by substantial evidence, see 16 U.S.C. 825*l*(b), and the Commission's reasonable conclusion should be upheld. See, *e.g.*, *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 477 (1951) (substantial evidence means "such relevant evi-

dence as a reasonable mind might accept as adequate to support a conclusion") (citation omitted).[5]

a. The Commission, agreeing with the findings of the ALJ, found that there was no evidence of any "market manipulation *specific to* the long-term contracts at issue." J.A. 1285a. Instead, it found that the contracts "were the result of choices voluntarily made" by the purchasers, and "to the extent the [purchasers] left themselves open to unnecessary risks, it was also their choice." J.A. 1284a. The purchasers were sophisticated parties, fully capable of protecting their own interests. Snohomish and SCWC signed their contracts after an extensive bid-solicitation and negotiation process in which they "voluntarily chose the length" of the contracts. J.A. 1282a. The Nevada companies reached their contracts through "independent third-party brokers" as part of an "aggressive procurement strategy" in which they sought "to buy as much power as they could before sellers discovered their already precarious financial position." J.A. 1280a. All of the purchasers "had better alternatives" available to them "and were not compelled to enter into the contracts at issue here." J.A. 1284a.

The Commission also found, based on its review of the entire record, that the purchasers had not shown a sufficient adverse effect on the rates paid by consumers to merit contract reformation. In the case of Snohomish, the contract led to an 8% increase in rates. J.A. 1279a, 1579a-1580a. The impact on customers of the other pur-

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[5] Under the substantial evidence standard, an agency's factual findings may be set aside only if a "reasonable factfinder would have to conclude" that the agency was wrong—*i.e.*, only if the agency would have to find that the evidence *compels* a contrary conclusion. *INS* v. *Elias-Zacarias*, 502 U.S. 478, 481 & n.1 (1992).

chasers was even less: the most pessimistic projections of the Nevada companies' witnesses suggested a 5% increase in rates, J.A. 1277a-1278a, 1577a-1578a, while SCWC admitted that permanent residents in its service territory had seen no rate increases at all, J.A. 1278a. Nor did the purchasers establish that the contracts threatened their financial health. J.A. 1277a (Nevada companies offered only "unsupported assertions of financial hardship."); J.A. 1278a ("[T]here is no evidence that the challenged contract placed SCWC in financial distress."); J.A. 1279a ("Snohomish presented no evidence that its contract * * * adversely affected Snohomish or its ratepayers."). Indeed, both Snohomish and SCWC made a profit, at least initially, by reselling power they purchased under the contracts. J.A. 1283a-1284a.

b. The court of appeals believed that FERC had failed to give adequate weight to the dysfunction in the spot market at the time the contracts were signed. Pet. App. 57a-60a. In fact, the Commission candidly acknowledged "that the California * * * spot markets were dysfunctional during the relevant period and that rates in those markets were unjust and unreasonable." J.A. 1275a. That is one reason why the Commission has made vigorous efforts to prevent similar dysfunction in the future by improving its regulation of market-based rates. See pp. 31-32, *supra*. But dysfunction in the spot market is not a reason to set aside contracts made in the forward market—which the court of appeals agreed could be analyzed as a separate market, Pet. App. 59a n.26—when there is no evidence of any independent dysfunction or manipulation there. To be sure, the dysfunction in the spot market had an effect on the prices available in the forward market. But that cannot be a suffi-

cient reason to abrogate all the forward market contracts. That market exists in part to allow parties to lock in rates and avoid the vagaries of the spot market. If the forward contracts can be abrogated just by pointing to distortions in the spot market, much of the value of the forward market contracts will be lost.

Once dysfunction in the spot market occurred, it was inevitable that it would impose costs on someone. The parties to these contracts presumptively had equal access to information about the functioning of the spot markets, and they made a knowing and intelligent choice about how to allocate risks and costs. Had the purchasers believed that the rates in their contracts might become unjust and unreasonable based on future developments in the spot market, they could have insisted on a clause preserving their right to seek Commission modification of the contracts. See *Memphis*, *supra*. Not only did they not do so, one of the purchasers, Snohomish, specifically disclaimed any right to ask the Commission for contractual modification. Pet. App. 194a. Spot-market dysfunction therefore provides no basis for relieving the purchasers of the assertedly "improvident bargain" to which they agreed. *Sierra*, 350 U.S. at 355.

The Commission also reasonably took into account the fact that the sellers under these contracts were themselves purchasers of power in the same market and therefore also faced the risk of price fluctuations. J.A. 1261a ("[T]he sellers in this case had to purchase power in the open market at prevailing market rates because they did not own generation to serve the market in question."). As the Commission explained in a companion order to the order at issue here, electricity is traded several times between the point of generation and the last wholesale purchaser, and attempting to unravel all

of the transactions would require "prolonged time and effort" and would be unlikely to produce "in the end, a fair result." *Puget Sound Energy, Inc.*, 103 F.E.R.C. ¶ 61,348, at 62,369, reh'g denied, 105 F.E.R.C. ¶ 61,183, at 61,956 (2003), review granted in part and denied in part *sub nom. Port of Seattle* v. *FERC*, 499 F.3d 1016 (9th Cir. 2007). And offering relief to only selected purchasers would be unlikely to promote the public interest.

Significantly, neither the purchasers nor the court of appeals identified any evidence suggesting that the contracts at issue here were unjust or unreasonable at the time they were signed. The purchasers, like the sellers, understood that prices for electricity, like prices for anything else, can go down as well as up. Indeed, "[b]y SCWC's own admission, at the time of contract execution, it *expected* the prices to drop." J.A. 1283a (emphasis added). By signing the contracts, the purchasers obtained protection against future price volatility. J.A. 1592a. As Snohomish explained to its ratepayers, its contract provided "a lot of security against the uncertainty of market fluctuations." Pet. App. 166a. Such security will only be available in the long run if sellers as well as buyers can count on contracts being enforced.

Long-term contracts are a principal means by which parties "allocate the risk of market price changes between the parties." *San Diego Gas & Elec. Co.*, 904 F.2d at 730. That is why part of the Commission's response to the 2000-2001 energy crisis was to encourage greater reliance on long-term contracts. See *San Diego Gas & Elec. Co.*, 93 F.E.R.C. ¶ 61,294, at 61,993 (2000) ("[W]e strongly urge [purchasing utilities] to move their load to long-term contracts of two years or more."). It would make little sense to declare such contracts void

simply because of the spot-market dysfunction they sought to overcome.

c. In sum, the Commission was faced with unprecedented circumstances and conflicting submissions on significant factual issues. The Commission considered the evidence in the operative legal context and found that the public interest standard for setting aside rates set by contract had not been satisfied. The court of appeals did not find that the Commission's decision was unsupported by substantial evidence, contrary to the text of the FPA, or inconsistent with this Court's decisions in *Mobile* or *Sierra*. Instead, the court created a new legal test to govern cases brought by purchasers under market-based rate contracts. For the reasons discussed above, the court of appeals' imposition of its new test failed to accord the required *Chevron* deference to the Commission's decision, which in turn was faithful to this Court's decisions in *Mobile* and *Sierra*. The court's test was neither necessary nor appropriate for proper judicial review of the Commission's decision.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 2007

APPENDIX

1. 16 U.S.C. 824 provides:

Declaration of policy; application of subchapter

(a) Federal regulation of transmission and sale of electric energy

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric

energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

(2) The provisions of sections 824i, 824j, and 824k of this title shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this chapter with respect to such provisions. Compliance with any order of the Commission under the provisions of section 824i or 824j of this title, shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

(c) Electric energy in interstate commerce

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

(d) "Sale of electric energy at wholesale" defined

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

(e) "Public utility" defined

The term "public utility" when used in this subchapter and subchapter III of this chapter means any person who owns or operates facilities subject to the jurisdiction of the Commission under this subchapter

(other than facilities subject to such jurisdiction solely by reason of section 824i, 824j, or 824k of this title).

(f) United States, State, political subdivision of a State, or agency or instrumentality thereof exempt

No provision in this subchapter shall apply to, or be deemed to include, the United States, a State or any political subdivision of a State, any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly owned, directly or indirectly, by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

(g) Books and records

(1) Upon written order of a State commission, a State commission may examine the books, accounts, memoranda, contracts, and records of—

(A) an electric utility company subject to its regulatory authority under State law,

(B) any exempt wholesale generator selling energy at wholesale to such electric utility, and

(C) any electric utility company, or holding company thereof, which is an associate company or affiliate of an exempt wholesale generator which sells electric energy to an electric utility company referred to in subparagraph (A),

wherever located, if such examination is required for the effective discharge of the State commission's regulatory responsibilities affecting the provision of electric service.

(2) Where a State commission issues an order pursuant to paragraph (1), the State commission shall not publicly disclose trade secrets or sensitive commercial information.

(3) Any United States district court located in the State in which the State commission referred to in paragraph (1) is located shall have jurisdiction to enforce compliance with this subsection.

(4) Nothing in this section shall—

(A) preempt applicable State law concerning the provision of records and other information; or

(B) in any way limit rights to obtain records and other information under Federal law, contracts, or otherwise.

(5) As used in this subsection the terms "affiliate", "associate company", "electric utility company", "holding company", "subsidiary company", and "exempt wholesale generator" shall have the same meaning as when used in the Public Utility Holding Company Act of 1935 [15 U.S.C. 79 et seq.].

2. 16 U.S.C. 824d provides:

Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations

affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such

notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five-month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change of rate, charge, classification, or service shall go into effect at

the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; "automatic adjustment clause" defined

(1) Not later than 2 years after November 9, 1978, and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both),

without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

3. 16 U.S.C. 824e provides:

Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.; statement of reasons for changes; hearing; specification of issues

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

(b) Refund effective date; preferential proceedings; statement of reasons for delay; burden of proof; scope of refund order; refund orders in cases of dilatory behavior; interest

Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. Upon institution of a proceeding under this section, the Commission shall give to the decision of such proceeding the same preference as provided under section 824d of this title and otherwise act as speedily as possible. If no final decision is rendered by the refund effective date or by the conclusion of the 180-day period commencing upon initiation of a proceeding pursuant to this section, whichever is earlier, the Commission shall state the reasons why it has failed to do so and shall state its best estimate as to when it reasonably expects to make such decision. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission may order the public utility to make refunds of any

amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: *Provided*, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.

(c) Refund considerations; shifting costs; reduction in revenues; "electric utility companies" and "registered holding company" defined

Notwithstanding subsection (b) of this section, in a proceeding commenced under this section involving two or more electric utility companies of a registered holding company, refunds which might otherwise be payable under subsection (b) of this section shall not be ordered to the extent that such refunds would result from any portion of a Commission order that (1) requires a decrease in system production or transmission costs to be paid by one or more of such electric companies; and (2) is based upon a determination that the amount of such decrease should be paid through an increase in the costs to be paid by other electric utility companies of such

registered holding company: *Provided*, That refunds, in whole or in part, may be ordered by the Commission if it determines that the registered holding company would not experience any reduction in revenues which results from an inability of an electric utility company of the holding company to recover such increase in costs for the period between the refund effective date and the effective date of the Commission's order. For purposes of this subsection, the terms "electric utility companies" and "registered holding company" shall have the same meanings as provided in the Public Utility Holding Company Act of 1935, as amended [15 U.S.C. 79 et seq.].

(d) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

4. 16 U.S.C. 825*l* provides:

Review of orders

(a) Application for rehearing; time periods; modification of order

Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issu-

ance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b) of this section, the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.

(b) Judicial review

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file

with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

(c) Stay of Commission's order

The filing of an application for rehearing under subsection (a) of this section shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.